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SIPDIS

PASS TREASURY FOR OASIA/ICB/VIMAL ATUKORALA
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SECDEF FOR OSD/ISP/EUR
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SUBJECT: AUSTRIA'S GROWTH FORECAST OPTIMISTIC, BUT
DOWNSIDE RISKS AND PERSISTENT UNEMPLOYMENT REMAIN

REFS: A) VIENNA 1097; B) 04 VIENNA 1124; C) 04 VIENNA

0273

SUMMARY

1. According to a recent forecast from the Austrian Institute for Economic Research (WIFO), the Austrian economy should grow at an average annual real rate of 2.3% during 2005-2009. WIFO cautioned that further Euro appreciation would negatively affect this projection, and that sustained growth would depend on increased domestic demand, not only on export growth. Austria will benefit from a dynamic global economy, including strong growth in China and continued strong demand in neighboring markets in Central and Eastern Europe. The WIFO projections would exceed predicted average growth in the Euro area and in Germany, but would be insufficient to reduce the 4.5% unemployment rate. Unemployment will remain a key focus for domestic economic policies. End Summary.

Slightly Stronger Economic Growth Ahead

2. At a projected annual average growth rate of 2.3%, Austria's growth over the next five years should outpace the 1.6% recorded for the past five years (2000-2004), according to the Austrian Institute for Economic Research's (WIFO) recently revised mid-term forecast. The main stimulus for Austria's growth will remain exports. However, recovery of domestic demand will be critical. WIFO believes strong export performance should translate into more investment activity and private consumption. Under these conditions, private consumption should grow at an annual average rate of 2.1% during 2005-2009, after growth of only 1.4% in 2000-2004. Rising employment, lower inflation and the GoA's 2005 income tax cut (ref C) should stimulate private consumption.

The International Scenario

3. WIFO based its 2005-2009 forecasts on the following assumptions:
-- U.S. average economic growth of 3.3%;
-- EU-25 average economic growth of 2.3%;
-- Euro area average economic growth of 2.1%;
-- average economic growth in the new EU-10 of 4.4%;
-- German average economic growth of 1.5%;
-- oil prices averaging USD 38 per barrel, with a decline from USD 44 per barrel in 2005 to USD 36 in 2008-2009;
and
-- an average dollar/Euro exchange rate of 0.81, with an improvement from 0.75 in 2005 to 0.87 in 2009.

4. The forecast assumes continued dynamic developments in the world economy, particularly in China, which remains a driving force for global economic growth. WIFO predicts growth in the U.S. will weaken slightly because of higher interest rates and a more restrictive fiscal policy, but will remain higher than in the Euro area. Austria will continue to benefit from the dynamic global economy because of its favorable international competitiveness (a result of high productivity increases and moderate wage increases in recent years), strong demand in neighboring Central and Eastern European markets, and GoA policies promoting a more competitive business environment.

Risks - Exchange Rates, Oil Prices, Private Consumption

5. A major caveat for the forecast is a deterioration of international parameters, especially the overvalued Euro. WIFO assumes a gradual depreciation of the Euro vis--vis the USD. Any further appreciation of the Euro would

dampen growth in the entire Euro area. A permanently high oil price would have a similar effect. In the Euro area, there is an additional risk that economic policies to overcome weak domestic demand will not be effective. Thus, this forecast clearly bears more downside risks, according to WIFO.

Persistent Unemployment - The Major Issue

16. There will be no turn-around in the labor market. The projected average economic growth of 2.3% will produce about 30,000 jobs annually (job growth rate of 0.9%). However, this will still be insufficient to produce a decline in the unemployment rate. Labor supply will keep pace with increasing labor demand, because of demographic developments - increased numbers of young people entering the labor market, pension reform that effectively raised the retirement age, and the continued influx of foreign labor. Thus, Austria's unemployment rate will remain at 4.5% throughout the entire 2005-2009 period.

17. Michael Landesmann, Research Director of the renowned Vienna Institute for International Economic Studies, said in a June 20 press interview that Austria would go through a structural crisis in the labor market over the next several years. According to Landesmann, the situation would be similar to the U.S. experience in the 1980s, when companies recorded strong profits, but shed jobs.

Comment

18. WIFO's cautious assumption that economic growth in 2005-2009 will reach the long-term average of about 2.5% may be too optimistic. Growth in the first quarter of 2005 (only 0.2% over the fourth quarter of 2004) was unexpectedly weak and therefore it is unlikely growth will achieve the projected 2005 growth rate of 2.2% (ref A). Stronger projected growth in 2005-2009 clearly represents upper limits. For domestic economic policies, the unemployment situation will remain key. The GoA has already downgraded its expectations - its 2002 National Action Plan for Employment (NAP) projected an unemployment rate of 3.5% for 2002, but the 2004 NAP revised the prediction upward to 4.3% for 2005.

19. WIFO Forecast of Economic Indicators for Austria
(average annual percent change, unless
otherwise stated)

	2000/2004	2005/09
Real terms:		
GDP	1.6	2.3
Private consumption	1.4	2.1
Public consumption	0.3	0.4
Plant and equipment investment	2.1	2.6
of which:		
machinery and equipment	3.7	3.5
construction	0.8	1.8
Domestic demand	1.0	2.0
Exports	6.2	6.4
Imports	5.2	6.3
Other indices:		
GDP deflator	1.6	1.6
Consumer prices	1.8	1.7
Employment growth	0.3	0.9
Unemployment rate (in percent)	4.1	4.5
Per capita payrolls, gross	2.0	2.3

BROWN